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Energy for a Changing World

Free allowance allocation under the EU ETS

The Economics, Politics and Future of Subsidies Workshop,

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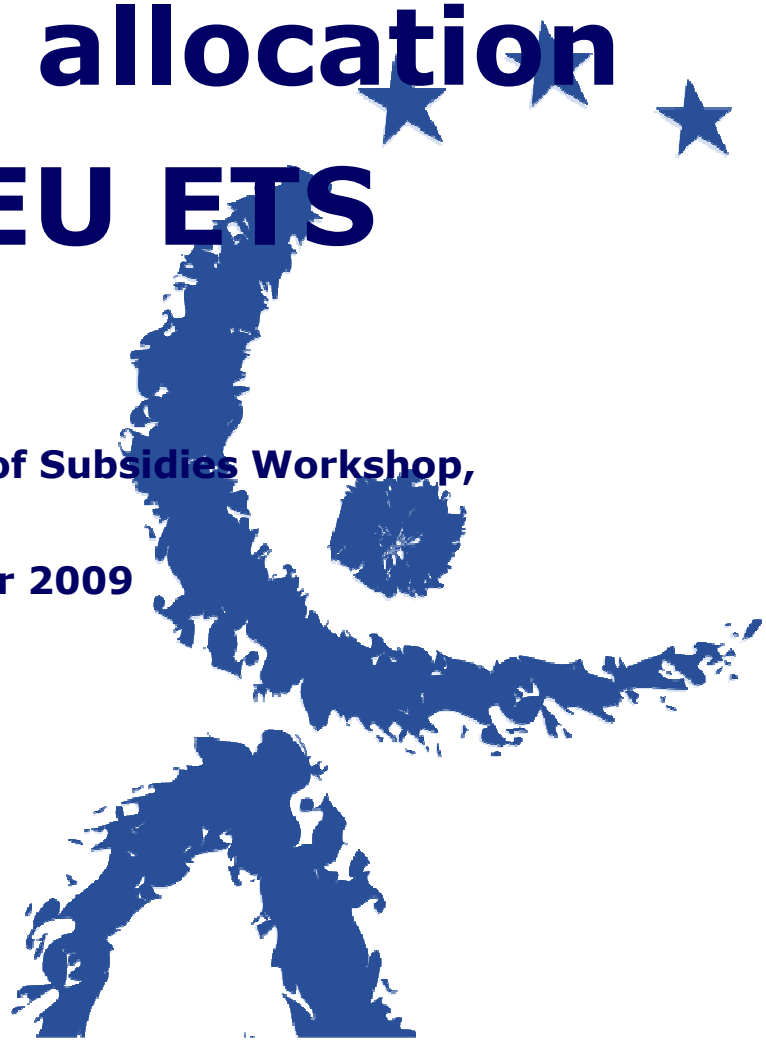

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The EU Climate Change and Energy Package: Political context

- Overall objective: limit temperature increase to 2°C (3.6°F) above pre-industrial level
- European Council March 2007: 20/20/20 by 2020
- Climate & Energy Package of legislation agreed in December 2008
- EU offer to Copenhagen: 30% emission reduction

Primary feature of the new ETS: A robust EU-wide cap beyond 2020

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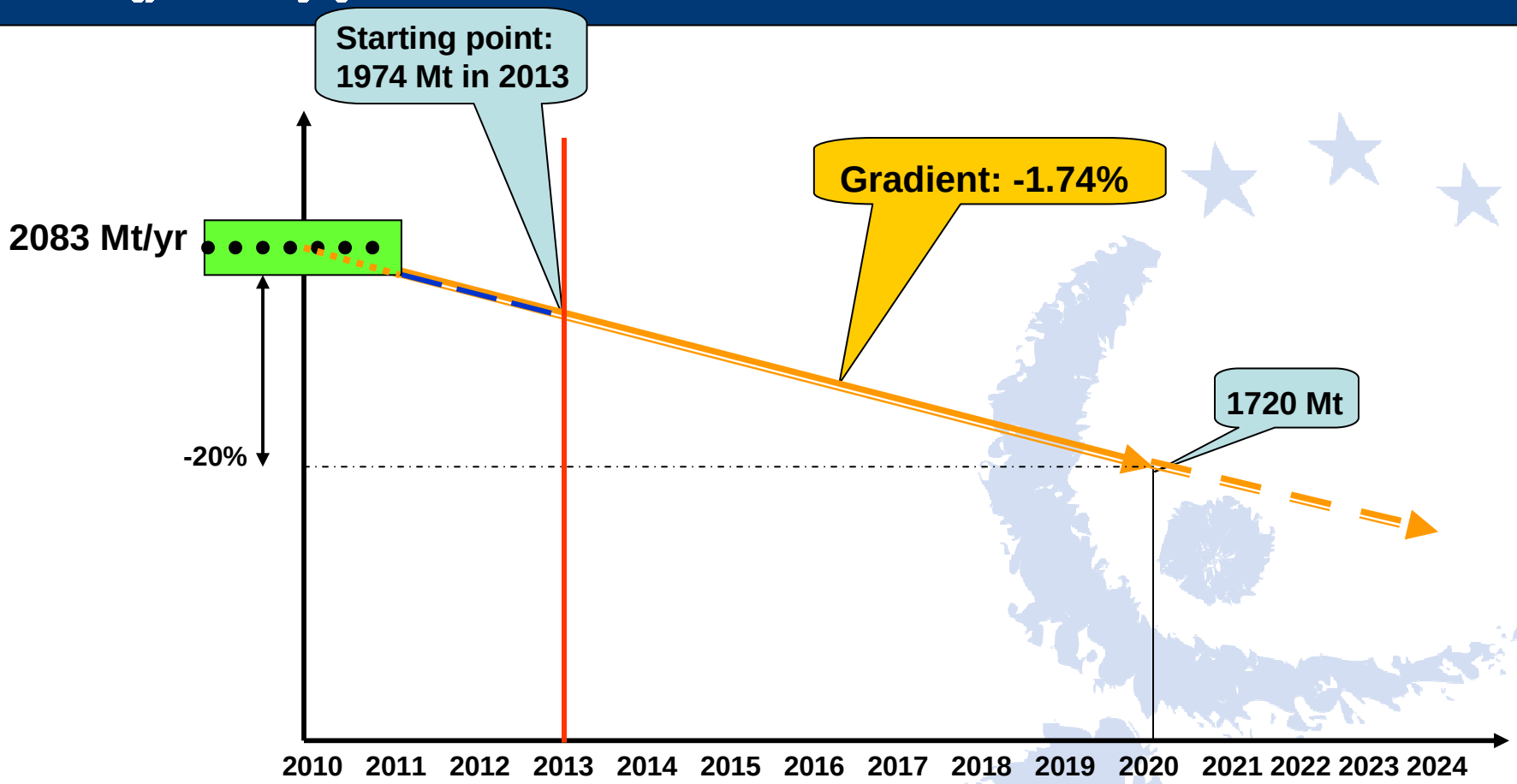

- Linear factor to be reviewed by 2025
- Aviation to be included; will change figures correspondingly, but cap not reduced
- Disclaimer: all figures are provisional and do not account for new sectors in third period

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Harmonised Allocation Rules

- Fully harmonised allocation rules
- Auctioning is default allocation method
- Free allocation on basis of ambitious ex-ante benchmark for those sectors receiving free allocation

Harmonised free allocation rules

- Community-wide harmonisation → No state aid risk, no distortion of competition
- Maximum determined by relative share of 2005-2007 industry's verified emissions
- Phasing out
  - On basis of ambitious ex-ante benchmarks
  - For sectors deemed not exposed to risk of carbon leakage: 80% in 2013 to 30% by 2020
  - For sectors deemed exposed to risk of carbon leakage: 100%
  - With a view to reaching full auctioning in 2027
- In the light of the outcome of the international negotiations, a report accompanied by any appropriate proposals (adjustment of level of free allocation, review of the carbon leakage list)

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Benchmarks

Ambitious

- Average performance of 10% most efficient installations
- Taking account of the most efficient techniques, substitutes, alternative production processes, high efficiency cogeneration, efficient energy recovery of waste gases, use of biomass and capture and storage of CO2

Ex-ante

- Allocations fixed prior to the trading period to enable the market to function properly
- Benchmarks to be multiplied with historic production to get amount of free allowances

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Why not ex-post benchmarking?

- Acts like an output subsidy
- Reduces the incentive for emission reductions
- Puts at serious risk the absolute cap
- Adds very substantial and continuous administrative burden, requiring competition sensitive data
- Creates significant uncertainty on the amount of free allocation for individual companies
- Makes the carbon market more volatile

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